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No. 90-672

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

GARY PLASTIC PACKAGING CORPORATION, a New York corporation, for itself and all others similarly situated,

Petitioner,

—v.—

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., a Delaware corporation, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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COUNTER-STATEMENT OF QUESTION PRESENTED

Whether in a securities fraud action the court of appeals correctly held that the district court had not abused its discretion in denying class certification on adequacy grounds, where the class representative was subject to unique defenses of lack of materiality, lack of reliance, waiver, estoppel and credibility which threatened to become the focus of the litigation to the detriment of the other class members.

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RULE AND STATUTES INVOLVED

The issue before this Court involves Rule 23 of the Federal Rules of Civil Procedure and, in particular, the typicality and adequacy provisions of Rule 23(a)(3) and (4) respectively. The suit was brought under Section 5 of the Securities Act of 1933, 15 U.S.C. § 77e; Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77q; Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j; and Rule 10b-5 thereunder. Petitioner also alleged violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962(c) (1982).

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Petitioner,

—v.—

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., a Delaware corporation, *et al.*,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Respondents Merrill Lynch, Pierce, Fenner & Smith Incorporated and Merrill Lynch Money Markets Inc.[1] respectfully request that this Court deny the petition for a writ of certiorari seeking review of the Second Circuit's decision in this case.

1 Pursuant to Rule 29.1 of the Rules of this Court, respondents state that respondent Merrill Lynch, Pierce, Fenner & Smith Incorporated is a wholly-owned subsidiary of Merrill Lynch & Co., a publically-held corporation. Respondent Merrill Lynch Money Markets Inc. is a wholly-owned subsidiary of Becker Holdings Incorporated, itself a wholly-owned subsidiary of Merrill Lynch Government Securities Inc., which is, in turn, a wholly-owned subsidiary of Merrill Lynch & Co. Neither respondent has any publically-traded subsidiaries.

STATEMENT OF THE CASE

Petitioner, a closely held corporation controlled by a family named Schur, brought an action in May 1983 against respondents, alleging fraud under the securities laws, and sought to be designated as the class representative of purchasers of various banks' $100,000 Certificates of Deposit (CDs) sold through the respondent Merrill Lynch.[2] The district court denied class representation, holding petitioner was an inadequate representative. The court held that, since petitioner had continued to purchase CDs even after it had discovered the alleged fraud, it was subject to unique defenses which disqualified it as a class representative. The court further held that the various family relationships among the officers of petitioner, the Merrill Lynch broker involved, and a member of petitioner's law firm furnished a further significant increment to the unique defense factor. The court also disqualified the petitioner's law firm, finding that Robert Schur, a member thereof and an officer, director, and shareholder of petitioner and its counsel who had investigated the claim, would be a necessary witness in the case (App. 17-22). Finally, the court dismissed the case upon petitioner's refusal to proceed (App. 4).[3] The court of appeals affirmed the denial of class status holding that either on grounds of typicality or adequacy the district court had not abused its discretion. It did not reach the questions of disqualification or dismissal. Rehearing and a suggestion of rehearing *en banc* were denied (App. 51-52).

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2 The CD program was created and administered by respondent Merrill Lynch Money Markets Inc. and they were sold through the Merrill Lynch, Pierce, Fenner & Smith Incorporated retail network. For present purposes they are jointly referred to herein as "Merrill Lynch." References to "(App. _____)" are references to the decisions set forth in Petitioner's Appendix.

3 Three months after the order, petitioner filed a motion for reargument which was denied as untimely. Following two successive status conferences "at which plaintiff made no meaningful appearance", the district court dismissed the action for failure to prosecute (App. 4).

THE FACTS

In 1978 the FDIC and FSLIC increased insurance levels on banks and savings and loan deposits to $100,000. Merrill Lynch, recognizing the advantages in Certificates of Deposit thus secured, instituted a program to market such CDs. Its program involved, *inter alia*, checking the credit-worthiness of some 15-20 participating institutions, selling the CDs of selected institutions at a yield determined by Merrill Lynch, and providing negotiability and liquidity for the investors through the maintenance of a secondary market for the CDs. The program offered the convenience of enabling prospective investors to purchase CDs directly through their Merrill Lynch broker rather than searching around the country for an appropriate CD (App. 26-29). It also enabled participating banks to broaden the sale and distribution of their CDs through the Merrill Lynch retail network. In September, 1980, Merrill Lynch made available an Information Bulletin describing the program which stated that Merrill Lynch would sell the $100,000 CDs at "competitive" rates.

To fix the rate for these CDs, Merrill Lynch traders would look daily at other market data such as the Treasury Bill rate and the institutional $1 million CD rate for thrift institutions. It would then offer participating institutions the opportunity to sell their CDs through Merrill Lynch at a rate which it determined was competitive. The banking institutions which issued the CDs generally paid Merrill Lynch 50 basis points (or 0.50 per cent per annum), subsequently reduced to 35 basis points, for its services.

In the spring of 1982 Howard Schur, a Merrill Lynch broker and cousin of Marilyn Schur Hellinger, suggested to Gary Hellinger, Marilyn's husband and Chief Executive Officer of Gary Plastic, that it purchase $100,000 CDs through Merrill Lynch. Howard recommended the investment because the CDs yielded higher yields than the money market funds where Gary Plastic had been depositing its cash. Hellinger testified that Howard told him that he could get the "best possible rate of interest." Howard Schur's testimony varied

as to whether he had told Hellinger he would get the "best rate possible" or a "competitive rate." He did recall telling Hellinger that he should contact the individual bank if he wanted to determine if he could do better by dealing with the bank directly. Hellinger denied this.

Gary Plastic purchased six 30-day $100,000 CDs in May 1982 through Howard Schur. In June it bought five more through him and in July it bought an additional CD. On July 1 Robert Schur, brother of Marilyn, bought a 30-day $100,000 CD through Howard Schur, thus becoming a putative class member. Both Hellinger and Robert Schur relied on Howard Schur's representations; neither relied on any writings from Merrill Lynch (App. 13).

Late in July 1982, Hellinger received a phone call from Peter Thomas, a representative of the State Savings & Loan Association, one of the banking participants in the Merrill Lynch CD program. He claimed that Thomas offered to sell Gary Plastic a $100,000 CD directly[4] at a rate 1½% or 2% higher than the rate it had received from a purchase of a State CD through Merrill Lynch. Hellinger, professing to be "very, very upset" about this information, called his attorney, Robert Schur, and asked him to investigate the matter and Robert did so (App. 13-14). Hellinger did not call Howard Schur, his wife's cousin and Gary Plastic's broker, who sold it the Merrill Lynch-sponsored CDs.

Despite this discovery, as the original CDs matured, petitioner bought additional CDs of the same issuers through Merrill Lynch. Thus, on August 24 and 25, 1982, Gary Plastic bought two more $100,000 CDs through Howard Schur. On October 19, 1982, Gary Plastic bought an additional $100,000 CD through Merrill Lynch and Howard Schur, and again on October 25, 1982 bought another $100,000 CD through Merrill Lynch (App. 14).

There was conflicting testimony as to whether the subsequent purchases were authorized by Hellinger. Petitioner's

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4 These so-called "window" CDs did not have the advantages of the Merrill Lynch program, *e.g.*, liquidity, negotiability and convenience.

bookkeeper, Muriel Kaye, testified that she always informed Hellinger of a CD rollover made in his absence. Hellinger denied having been informed of the subsequent purchases (App. 14).

Gary Plastic decided to bring this action at a family holiday meeting of directors at the Hellingers' home in 1983. Robert Schur recommended that Gary Plastic retain one of his partners at Bailey & Hunt, Guy B. Bailey, Jr., as class counsel. Mr. Bailey was not an experienced class counsel. Robert Schur testified that by agreement with Mr. Bailey he, Robert, had received a contingent interest in the case, that he would receive double his hourly rate for working on the case, and would share equally in any recovery above that if the class action were successful (App. 15).

The original complaint was dismissed by the district court on the grounds, *inter alia*, that the CDs at issue were not securities within the meaning of the various securities acts. The court of appeals reversed chiefly on the grounds that these CDs were securities within the meaning of the antifraud provisions of the various securities acts (App. 23-50) and on remand the petitioner filed an amended complaint and moved for class certification. The district court denied class certification, holding that as a result of its purchases after acquiring knowledge of its purported claim, Gary Plastic was subject to unique defenses including lack of materiality, lack of reliance, waiver and estoppel (App. 19) which disqualified it, on adequacy grounds, as a class representative. The court of appeals affirmed this decision as a proper exercise of the trial court's discretion (App. 8). As noted, *supra* p. 2, it did not reach the attorney disqualification and dismissal issues.

ARGUMENT

REASONS FOR DENYING THE WRIT

1. There Is No Important Federal Issue Involved

The instant petition presents no significant question for this Court to decide. Rather, it reflects only petitioner's disagreement with the district court's proper exercise of its discretion in refusing to certify a class. In this fact-specific matter there is no pending question of importance or public concern. Indeed, the matter can only be of concern to the parties and, more particularly, to purported class counsel. It is most unlikely that the particular combination of unique defenses, enhanced by the troublesome credibility issues arising from the close family relationship here involved could again arise in a class context. There is no reason for yet another judicial review of the district court's appropriate exercise of its discretion.[5]

2. There Is No Conflict With This Court's Decisions or the Decisions of Any Federal Circuit Court of Appeals

There are patently no conflicts with any decision of this Court or other federal circuit courts inherent in the decisions below. In an effort to create the appearance of a conflict, petitioner suggests that the decision below violates the policy that a liberal interpretation should be given class action determinations (Petition 9-10). Both lower courts recognized a liberal standard applied (App. 8, 16). But the favor with which

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5 Petitioner is in error in its repeated assertion (Petition i, 10) that an otherwise unspecified Statute of Limitations has run as to the claim of the individual class members. The law is clear that the pendency of a class action tolls the Statute of Limitations as to the individual members until the class action status is determined. *Crown Cork & Seal Co.* v. *Parker*, 462 U.S. 345, 353-54 (1983); *American Pipe & Constr. Co.*, v. *Utah*, 414 U.S. 538, 553, *reh'g denied*, 415 U.S. 952 (1974). Furthermore, this tolling continues throughout the appeal process. *Edwards* v. *Boeing Vertol Co.*, 717 F.2d 761, 766 (3d Cir. 1983), *vacated mem.*, 468 U.S. 1201 (1984), *reinstated on remand*, 750 F.2d 13 (3d Cir. 1984).

the courts have approached the class action device in no way means any relaxation of the standards which must be met for certification. Indeed, the contrary is true. *General Tel. Co.* v. *Falcon*, 457 U.S. 147, 161 (1982); *East Texas Motor Freight Sys., Inc.* v. *Rodriguez*, 431 U.S. 395, 405-06 (1977). As this Court stated in *Falcon*:

> With the same concerns in mind, we reiterate today that a Title VII class action, like any other class action, may only be certified if the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied.

457 U.S. at 161.

As the Second Circuit stated in *Rossini* v. *Ogilvy & Mather*, 798 F.2d 590, 597 (1986): "In the wake of *Falcon*, courts have been generally strict in their application of the Rule 23(a) criteria." The policy favoring class actions was, here, simply outweighed, in the court's discretion, by the pervasive defenses to petitioner's claims, which set it apart from the other class members and rendered its claims atypical and it an inadequate class representative. Contrary to the petitioner's contention (Petition 10), the lower courts properly weighed the applicable standards applied to class actions. The result simply was that the strict analysis required by *Falcon* and succeeding decisions of the circuit courts[6] prevailed. Contrary to the petitioner's view, there is no conflict herein at all with the decisions of this or any other federal court.

3. The District Court Did Not Abuse Its Undoubted Discretion In Holding That Unique Defenses Rendered Petitioner an Unsuitable Class Representative

The court of appeals held that the district judge in denying class certification had not abused his discretion. This was, of course the proper standard for its review. *Pattillo* v.

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6 *See, e.g., Sheehan* v. *Purolator, Inc.*, 839 F.2d 99, 103 (2d Cir.), *cert. denied*, 488 U.S. 891 (1988); *Robinson* v. *Lehman*, 771 F.2d 772, 783 (3d Cir. 1985); *Jordan* v. *County of Los Angeles*, 713 F.2d 503, 504 (9th Cir. 1984).

Schlesinger, 625 F.2d 262 (9th Cir. 1980); *Bogus* v. *American Speech & Hearing Ass'n*, 582 F.2d 277 (3d Cir. 1978); *Susman* v. *Lincoln Am. Corp.*, 561 F.2d 86 (7th Cir. 1977).

It is well established that the existence of defenses unique to an individual plaintiff will disqualify that plaintiff as a class representative on grounds of lack of typicality, inadequacy or both. *Warren* v. *Reserve Fund*, 728 F.2d 741, 747, *reh'g denied*, 734 F.2d 1479 (5th Cir. 1984); *Kline* v. *Wolf*, 702 F.2d 400, 403 (2d Cir. 1983); *J.H. Cohn & Co.* v. *A.M. Appraisal Assocs.*, 628 F.2d 994, 998 (7th Cir. 1980); *Koos* v. *First Nat'l Bank of Peoria*, 496 F.2d 1162, 1164 (7th Cir. 1974). As the Second Circuit stated here: "[r]egardless of whether the issue is framed in terms of the typicality of the representative's claims . . . or the adequacy of its representation . . . there is a danger that absent class members will suffer if their representative is preoccupied with defenses unique to it." (App. 8) (citations omitted). The reason for the rule is stated in *Koos*:

> Had this case proceeded as a class action, much of the Kooses' effort would have necessarily been devoted to their own problems posed by the Section 4(b) defense; this may well have resulted in less attention to the issue which would be controlling for the rest of the class. A representative plaintiff should not be permitted to impose such a disadvantage on the class.

496 F.2d at 1165.

Here, the petitioner's efforts to salvage its precarious claim would have to be at the expense of the class. It is difficult to take seriously a claim of fraud where the plaintiff, knowing of the alleged fraud, continues as though it did not exist. It simply becomes unimportant. Petitioner cannot show that the alleged fraud caused or affected its decision to purchase the CDs. Similarly, it is impossible to show the required reliance on the alleged fraud when the party knowing thereof continues as though it did not exist. It is no answer to say, as petitioner does (Petition 21, N. 16, citing *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153 (1972)), that "reli-

ance is presumed" in the case of an alleged omission or failure to disclose. Assuming, *arguendo*, that such a presumption could arise here, that presumption, of course, can be rebutted. *Basic Incorporated* v. *Levinson*, 485 U.S. 224, 245 (1988); *du Pont* v. *Brady*, 828 F.2d 75, 78 (2d Cir. 1987); *Chelsea Assocs.* v. *Rapanos*, 527 F.2d 1266, 1271-72 (6th Cir. 1975). Petitioner here is in the unique position of being faced with affirmative evidence which would rebut any such presumption of reliance.

The conduct here, upon which these defenses are based, is unique to the petitioner and would, obviously, be the centerpiece of the litigation to the detriment of the class not burdened with such problems. Nor are these defenses only to the damage claim, as petitioner suggests (Petition 19). They, together with waiver and estoppel, are equally fatal here to a finding of liability. In a fraud case, materiality and reliance are, of course, essential elements to the cause of action. Absent proof thereof, the claim must fail. As this Court stated in *Levinson*, 485 U.S. at 238:

> [I]n order to prevail on a Rule 10b-5 claim, a plaintiff must show that the statements were *misleading* as to a *material* fact. It is not enough that a statement is false or incomplete, if the misrepresented fact is otherwise insignificant.

Similarly, as stated in *Levinson* at 243:

> We agree that reliance is an element of a Rule 10b-5 cause of action. See *Ernst & Ernst* v. *Hochfelder*, 425 U.S., at 206 (quoting Senate Report). Reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury.

The petitioner necessarily would be preoccupied with these defenses, as well as those of waiver and estoppel, and the interests of the class it purports to represent would play only a secondary role. The district court in the exercise of its discretion correctly rejected a class representative faced with the burden of meeting these substantial defenses.

Further, the district court did not abuse its discretion in determining that the family relationship at bar furnished a "significant increment to the unique defense factor" (App. 20). The court was obviously referring to the credibility problems arising from the fact that the Merrill Lynch broker who made the alleged misrepresentation was a family member.[7] It was referring to the fact that another family member acted as an investor in the CDs, investigator of the claim, and proponent of his own law firm as class counsel. And it was, we believe, referring to the clearly incredible claim that Gary Hellinger, the Chief Executive Officer of Gary Plastic, did not know where some $400,000 of his small company's cash was placed and by whom it was placed after the original CDs had matured. These issues arising out of the family relationship reinforced the court's decision that Gary Plastic was not a proper class representative.

Petitioner's efforts to establish typicality (Petition 12-14) or adequacy (Petition 19-24) are essentially irrelevant. None of the cases cited deal with the disqualifying effect of the existence of unique defenses as they may relate to that requirement. Thus, for example, in *Penn* v. *San Juan Hosp.*, 528 F.2d 1181 (10th Cir. 1975) (Petition 13), the claims of lack of typicality and inadequacy of the class representatives were held to be irrelevant to their maintenance of the claims. The court held that, whatever the differences of residence or indigency, the representatives all were Navajo Indians who had been denied emergency medical benefits and could thus represent the class of Navajos on the same claim. *Gonzales* v. *Cassidy*, 474 F.2d 67 (5th Cir. 1973) (Petition 14) simply held that a class representative in a prior suit had been inadequate where he had failed to appeal a judgment which treated him differently from the class he sought to represent.

Nor does petitioner meet its problems as to adequacy by citation to cases involving conflicts of interest between the

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7 The broker, Howard Schur, clearly had little interest in assisting his former employer, Merrill Lynch. Thus, he refused to meet prior to his deposition with Merrill Lynch's attorneys although he had met with the petitioner's attorneys.

representative and the class (Petition 19-24). None involves the issue of unique defenses. For example, *Blackie* v. *Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976) (Petition 22) was concerned with whether common questions existed as to the necessity of proof of subjective reliance and whether conflicts existed within the class. There was no suggestion that disabling defenses peculiar to the class plaintiff existed.

When petitioner does discuss the unique defense issue, its cases are of no relevance. *Surowitz* v. *Hilton Hotels Corp.*, 383 U.S. 363, *reh'g denied*, 384 U.S. 915 (Petition 17) has nothing to do with the issue. It was a derivative suit instituted before the 1966 amendment of Rule 23. *Kennedy* v. *Tallant*, 710 F.2d 711 (11th Cir. 1988) (Petition 18) is equally inapposite. There, the court held that the fact that the class plaintiff had not read the prospectus involved was not significant since he had been the victim of other acts of fraud common to the class. Nor does *Kronfeld* v. *Trans World Air Lines, Inc.*, 101 F.R.D. 50 (S.D.N.Y. 1984), also relied upon by petitioner (Petition 16) advance its position. The court there simply held that the claimed "unique" defense was neither unique nor a defense in that case, since the fact that the plaintiff had relied on a third party's advice was a common practice among the proposed class and did not, there, vitiate a Section 10(b) claim. 104 F.R.D. at 53.

In short, petitioner simply has not addressed the problems raised by its conduct. The language and rationale in *Zenith Laboratories* v. *Carter-Wallace, Inc.*, 530 F.2d 508 (3d Cir.), *cert. denied*, 429 U.S. 828 (1976), is particularly applicable here. Thus, the court stated at 512:

> If Zenith were allowed to represent the alleged class, Carter could assert defenses against it which would not be applicable to the class as a whole, such as *res judicata* based on the disposition of Zenith's counterclaims in the earlier suit. Since these unique defenses could conceivably become the focus of the entire litigation and divert much of Zenith's attention from the suit as a

whole, the remaining members of the class could be severely disadvantaged by Zenith's representation.

The defenses unique as to the petitioner disable it as a class representative and the district court did not abuse its discretion in so holding.

CONCLUSION

For the reasons set forth, the Petition for a Writ of Certiorari should be denied.

Dated: November 21, 1990

Respectfully submitted,

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